



AUDITOR - GENERAL
SOUTH AFRICA

The accounting officer
Mkhondo Local Municipality
P.O Box 23
Piet Retief
2380

30 November 2013

Reference: 02394REG12/13

Dear Sir

Report of the Auditor-General on the financial statements and other legal and regulatory requirements of Mkhondo Local Municipality for the year ended 30 June 2013

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act of South Africa read in conjunction with section 188 of the Constitution of the Republic of South Africa section 121(3) of the Municipal Finance Management Act of South Africa (MFMA).
2. In terms of section 121(3) of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
3. Until the annual report is tabled as required by section 127(2) of the MFMA the audit report is not a public document and should therefore be treated as confidential.
4. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.
5. Please notify the Senior Manager well in advance of the date on which the annual report containing this audit report will be tabled.
6. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely



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Deputy Business Executive: Mpumalanga Business Unit

Enquiries: Avick Misra
Telephone: (013) 756 0800
Fax: (013) 756 0879

REPORT OF THE AUDITOR-GENERAL TO THE MPUMALANGA PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE MKHONDO LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the financial statements of the Mkhondo Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2013, the statements of financial performance, changes in net assets, cash flows and comparison of budget and actual amounts for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2012 (Act No. 5 of 2012) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Consumer debtors

4. I was unable to obtain sufficient appropriate audit evidence to support consumer debtors and the provision for bad debts disclosed in the financial statements. I was unable to confirm these by alternative means. In addition, the municipality did not carry its consumer debtors at amortised cost in accordance with the requirement of GRAP 104, *Financial instruments*. Consequently, I could not determine whether consumer debtors and the related provision for bad debts amounting to R110 871 804 and R97 133 191 disclosed in note 11 to the financial statements, respectively, were fairly stated.

Investment properties

5. Some properties in the fixed asset register could not be physically verified and properties belonging to the municipality could not be traced back to the fixed asset register. A further prior period adjustment of R8 155 000 was made to investment properties previously disclosed. I was unable to obtain sufficient appropriate audit evidence to support this adjustment. The accounting records of the municipality did not permit the performance of alternative procedures.
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6. The municipality did not always depreciate investment properties as required by GRAP 16, *Investment properties*.
7. Consequently, I was unable to determine whether investment properties amounting to R19 106 200 as disclosed in note 4 to the financial statements were fairly stated.

Property, plant and equipment

8. I was unable to obtain sufficient appropriate audit evidence to support adjustments made to property, plant and equipment amounting to R29 814 533 as disclosed in the financial statements. I was unable to confirm this by alternative means. In addition, the municipality did not always account for disposals and additions to property, plant and equipment. Consequently, I could not determine whether property, plant and equipment and depreciation amounting to R1 297 330 372 and R969 144 278 disclosed in note 5 to the financial statements, respectively, were fairly stated.

Other financial assets

9. I was unable to obtain sufficient appropriate audit evidence to support investments. I was unable to confirm this by alternative means. Consequently, I was unable to determine whether investments amounting to R19 047 996 as disclosed in note 7 to the financial statements were fairly stated.

Provisions

10. GRAP 19, *Provisions for contingent liabilities and contingent assets* requires that a liability of uncertain amount or timing must be recognised as a provision. The municipality incorrectly classified its accumulated leave pay that did not meet the criteria of uncertainty in amount or timing as a provision. Consequently, the provision is overstated and other payables are understated by R7 045 369.

Payables from exchange transactions

11. As the municipality did not have adequate systems to ensure that transactions were recorded when they occurred and not on upon payment, transactions amounting to R18 517 517 relating to the current and prior period were not recorded in the accounting records as account payables. In addition, the debtors balance was incorrectly classified as a payable from exchange transaction amounting to R18 115 076.
12. I was unable to obtain sufficient appropriate audit evidence to support prior period adjustments of R27 608 880. I was unable to confirm this adjustment by alternative means.
13. Consequently, I was unable to determine whether adjustments to payables from exchange transactions stated at R15 404 612 in note 16 to the financial statement were necessary.

Unspent conditions grants

14. I was unable to obtain sufficient appropriate audit evidence to support the prior period adjustment of R19 924 284 relating to unspent conditional grants. I was unable to confirm this adjustment by alternative means. Consequently, I was unable to determine whether adjustments to unspent conditional grants disclosed at R38 833 402 in note 14 to the financial statements were necessary.
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Accumulated surplus

15. I was unable to obtain sufficient appropriate audit evidence to support the prior period adjustment of R31 863 429 relating to the accumulated surplus. I was unable to confirm this adjustment by alternative means. Consequently, I was unable to determine whether adjustments to accumulated surpluses stated at R133 616 197 in the statement of changes in net assets were necessary.

Revenue

16. The municipality did not always update the accounting records with the value of improvements made during the financial year. The effect of this is an understatement of revenue from property rates.
17. The municipality did not ensure that the electricity and water meter readings were done on a monthly basis. The municipality's records did not permit the performance of alternative procedures. In addition, the municipality did not always recognise grants as revenue when conditions were met, as required by GRAP 23.
18. Consequently, I was unable to determine whether revenue as presented in the financial statements was fairly stated.

Cash flow statement

19. I was unable to obtain sufficient appropriate audit evidence as to whether the cash flow statement was fairly stated, due to the items contributing to the basis for the disclaimer of audit opinion.

Commitments

20. I was unable to obtain sufficient appropriate audit evidence to support commitments amounting to R92 327 921 as disclosed in note 38 to the financial statements. I was unable to confirm this through alternative means. Consequently, I was unable to determine whether commitments were fairly stated.

Contingent liability

21. I was unable to obtain sufficient appropriate audit evidence for the job evaluation in response to the wage curve collective agreement signed by the South African Local Government Association on behalf of the municipality. I was unable to confirm this through alternative means. Consequently, I was unable to determine whether the contingent liability was fairly stated in note 39 to the financial statements.

Irregular expenditure

22. I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of irregular expenditure amounting to R19 230 910 as disclosed in note 46 to the financial statements, due to a limitation placed on the auditing of procurement. Irregular expenditure was identified during my audit.
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Material losses

23. I was unable to obtain sufficient audit evidence to support distribution losses relating to water and electricity disclosed in the financial statements. Furthermore, the municipality did not have systems to ensure that these losses were properly calculated, as free basic services were included in the distribution losses. Consequently, I was unable to determine whether the distribution loss of R30 374 609 was fairly stated.

Aggregation/Accumulation of immaterial uncorrected misstatements

24. The financial statements as a whole are materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following elements making up the statement of financial position, statement of financial performance and notes to the financial statements:

Statement of financial position

- Long-term liabilities as reflected as R4 176 971 are overstated by R1 140 146.
- Non-current assets held for sale are overstated by R410 000.
- Trade payables are understated and trade receivables are overstated by R1 938 749.
- Consumer deposits are misstated by an unknown amount.
- Inventory is misstated by the prior year issue of R1 596 175.
- Taxes and transfers payable (non-exchange) are misstated by an unknown amount.
- Other financial liabilities are misstated by the prior year issue of R2 948 248.
- Other financial assets are misstated by the prior year issue of R1 124 713.
- Value-added tax is misstated by a projected amount of R2 854 133.

Statement of financial performance

- Revenue reflected as R290 923 193 is understated by R645 000.
- Employee costs reflected as R86 756 665 are overstated by R1 206 022.
- Interest expense reflected as R1 184 293 is overstated by R597 930.
- Expenditure reflected as R320 159 693 is misstated by R2 939 017.

Disclaimer of opinion

25. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.
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Emphasis of matter

26. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Material impairments

27. As disclosed in note 11 to the financial statements, material impairments of R19 521 567 were incurred as a result of the impairment of consumer debtors.

Additional matter

28. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited supplementary information

29. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited this schedule and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

30. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

31. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages xx to xx of the annual report.
32. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability.
33. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury's annual reporting principles and whether the reported performance is consistent with the planned objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
34. The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).
35. The material findings are as follows:
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Usefulness of information

Presentation

36. Section 46 of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA) requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Adequate and reliable corroborating evidence could not be provided for 97% of the measures taken to improve performance as disclosed in the annual performance report. This was due to limitations placed on the scope of my work. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the reliability of the measures taken to improve performance.
37. Section 46 of the MSA requires disclosure in the annual performance report of measures taken to improve performance where planned targets were not achieved. Measures to improve performance for 35% of the planned targets not achieved were not reflected in the annual performance report. This was due to a lack of review by management of the annual performance report.

Consistency

38. Section 41(c) of the MSA requires that the service delivery agreement should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 53% of the reported objectives, indicators and targets were not consistent with the objectives, indicators and targets as per the approved service delivery agreement. This was due to a lack of a performance management system.

Measurability

39. The FMPPI requires that performance targets be specific in clearly identifying the nature and required level of performance. A total of 44% of the targets were not specific in clearly identifying the nature and the required level of performance. This was because management was aware of the requirements of the FMPPI but chose not to apply the principles contained in the FMPPI.
 40. The FMPPI requires that performance targets be measurable. The required performance could not be measured for 100% of the targets. This was because management was aware of the requirements of the FMPPI but did not implement the principles contained in the framework.
 41. The FMPPI requires that it must be possible to validate the processes and systems that produce the indicator. A total of 100% of the targets were not verifiable in that valid processes and systems that produced the information on actual performance did not exist. This was due to a lack of key controls in the relevant systems of collection, collation, verification and storage of actual performance information.
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Reliability of information

42. The FMPPI requires that institutions should have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the information presented with respect to basic service delivery. This was due to limitations placed on the scope of my work and the fact that the municipality could not provide sufficient appropriate evidence in support of the information presented with respect to the development priority.

Compliance with laws and regulations

43. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the general notice issued in terms of the PAA are as follows:

Annual financial statements, performance report and annual report

44. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected and the supporting records could not be provided subsequently, which resulted in the financial statements receiving a disclaimer of audit opinion.
45. The 2011-12 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
46. The 2011-12 annual report was not made public immediately after the annual report had been tabled in the council, as required by section 127(5)(a) of the MFMA.
47. An oversight report, containing comments on the annual report, was not adopted by the council within two months from the date on which the 2011-12 annual report had been tabled, as required by section 129(1) of the MFMA.
48. The council's oversight report on the 2011-12 annual report was not made public within seven days of its adoption, as required by section 129(3) of the MFMA.

Asset and liability management

49. An adequate management, accounting and information system was not in place to account for assets, as required by section 63(2)(a) of the MFMA.
50. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Budget

51. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.
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Expenditure management

52. Money owing by the municipality was not always paid within 30 days or an agreed period, as required by section 65(2)(e) of the MFMA.
53. An effective system of expenditure control was not in place, including procedures for the approval, authorisation, withdrawal and payment of funds, as required by section 65(2)(a) of the MFMA.
54. Reasonable steps were not taken to prevent unauthorised, irregular as well as fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
55. An adequate management, accounting and information system was not in place to recognise expenditure when it was incurred and to account for creditors and payments made, as required by section 65(2)(b) of the MFMA.

Consequence management

56. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
57. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
58. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, in accordance with the requirements of section 32(2) of the MFMA.
59. Unauthorised, irregular as well as fruitless and wasteful expenditure was not always recovered from the liable person, as required by section 32(2) of the MFMA.
60. The accounting officer did not always report cases of alleged irregular expenditure that constituted a criminal offence to the South African Police Service, as required by section 32(6) of the MFMA.

Human resource management

61. Sufficient appropriate evidence could not be obtained that job descriptions had been established for all posts in which appointments were made in the current year, as required by section 66(1)(b) of the MSA.
62. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and the relevant provincial treasury, as required by Minimum Competency Levels Regulation 14(2)(a).
63. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by Minimum Competency Levels Regulation 14(2)(b) and 14(3).
64. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate the performance of staff, in contravention of section 67(d)

of the MSA.

Procurement and contract management

65. Sufficient appropriate evidence could not be obtained that goods and services with a transaction value below R200 000 had been procured by obtaining the required price quotations, as required by Supply Chain Management (SCM) Regulation 17(a) and (c).
66. Invitations for competitive bidding were not always advertised for the required minimum period, contrary to SCM Regulation 22(1) and 22(2).
67. The preference point system was not applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) and SCM Regulation 28(1)(a).
68. Sufficient appropriate audit evidence could not be obtained that contracts and quotations had been awarded only to providers whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM Regulation 43.
69. Contracts and quotations were awarded to bidders who had not submitted a declaration on whether they were employed by the state or connected to any person employed by the state, as required by SCM Regulation 13(c).
70. Awards were made to providers who were in the service of the municipality, in contravention of section 112(j) of the MFMA and SCM Regulation 44. Furthermore, providers failed to declare that they were in the service of the municipality, as required by SCM Regulation 13(c).

Revenue management

71. An adequate management, accounting and information system was not in place to account for revenue, debtors and receipts of revenue, as required by section 64(2)(e) of the MFMA.
72. Sufficient appropriate audit evidence could not be obtained that revenue due to the municipality had been calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.
73. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

Strategic planning and performance

74. The municipality did not give effect to its integrated development plan and did not conduct its affairs in a manner consistent with its integrated development plan, as required by section 36 of the MSA and section 21(2)(a) of the MFMA.
 75. The annual performance report for the year under review did not include the performance of each external service provider, a comparison with the previous financial year and measures taken to improve performance, as required by section 46(1)(a), (b) and (c) of the MSA.
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Internal control

76. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the disclaimer of opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

77. Oversight responsibility was not exercised regarding financial and performance reporting and compliance as well as related internal controls.
78. Effective human resource management was not implemented to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored.
79. The implementation of action plans was not monitored to address internal control deficiencies.

Financial and performance management

80. Proper record keeping was not implemented in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting, resulting in insufficient audit evidence for audit purposes.
81. Controls were not implemented over daily and monthly processing and reconciling of transactions.
82. Regular, accurate and complete financial and performance reports, which were supported and evidenced by reliable information, were not prepared.

OTHER REPORTS

Investigations in progress

83. An investigation is being conducted to probe the manner in which funds of the municipality were not deposited into the municipality's bank account by employees working in the licensing department. The investigation was still ongoing at the reporting date.

Auditor - General

Nelspruit

30 November 2013



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence